Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Campbell	Analyst:	Kimberly Pantoja	Bill Number:	AB 1262
Related Bills:	See Legislative History	Telephone:	845-4786	Amended Date:	1/3/2000
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Employer Provided Health Care Coverage Credit

SUMMARY OF BILL

Under the Bank and Corporation Tax Law (B&CTL), this bill would provide a credit for amounts paid or incurred during the income year by an eligible employer to provide health coverage for an eligible individual and that individual's dependent or dependents.

SUMMARY OF AMENDMENT

The January 3, 2000, amendments replace the Legislature’s intent language to enact tax incentives for California businesses to make quality health insurance available to their employees with the provisions discussed in this analysis.

EFFECTIVE DATE

As a tax levy, this bill would apply to income years beginning on or after January 1, 2000; however, this bill specifies that it would apply to income years beginning on or after January 1, 2001, and does not specify a sunset date.

LEGISLATIVE HISTORY

AB 1172 (1999), AB 2520 (1998), and AB 148 (1997) each proposed Employer Provided Health Care Credit for Farmworkers and failed passage in policy committee.

SPECIFIC FINDINGS

Under federal law, to which California conforms, an employer's contribution to an employee accident or health plan is not includable in the employee's gross income.

Existing federal and state laws allow ordinary and necessary business expenses to be deducted, which would include health care coverage premiums paid for employee accident or health plans.

Existing state and federal laws provide various tax credits that are designed to provide tax relief for taxpayers who must incur certain expenses (e.g., child and dependent care credit) or to influence behavior, including business practices and decisions (e.g., research credits).

Current federal and state laws do not currently provide credits for any health care costs. Prior **state law** would have provided a small-employer health coverage tax credit (SB 2260, Ch. 1521, Stats. 1988). However, the credit was repealed before becoming operative.

Board Position:			Department Director	Date
______ S	______ NA	______ NP	Alan Hunter for G.H.G	01/10/00
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This bill would provide a credit for amounts paid or incurred during the income year by an eligible employer, who employs on the average during the income year no more than 50 employees, to provide health coverage for an eligible individual, who is a resident of California, and that individual's dependent or dependents.

This bill specifies the amount of the credit shall be $25 per month per covered individual or 25% of the total amount paid or incurred per month for that health coverage by the employer during the income year, whichever is more. To qualify for the credit, an eligible employer must pay or incur at least 75% of the monthly premium for health coverage for eligible individuals who elect to have that coverage and for which those individuals do not pay more than 25%. At least annually, the employer shall make participation available to all eligible individuals. Participation shall be made available to all newly hired eligible individuals within 60 days of the date of employment. An employer may qualify for the credit regardless of whether the participation is made available to all individuals who perform services for less than 35 hours per week. Nothing shall prohibit an employer from making additional health benefits available to an eligible individual at the employer's or eligible individual's expense.

This bill specifies that no deduction would be allowed for the same expenses for which the credit was allowed.

This bill would allow a carryover of any portion of this credit that exceeds the taxpayer’s tax liability until the credit is exhausted. This bill specifies the division of credit between employers who share in the expenses and among corporate partners in a partnership. This credit would not reduce regular tax below tentative minimum tax for purposes of the alternative minimum tax.

This bill would define several terms, including "eligible employer," "eligible individual," "health coverage," "basic health care services," "dependent," and "supplemental benefits."

An eligible employer shall be entitled to an additional $5 tax credit per month per covered employee for each of two supplemental benefits, as defined in the bill.

This bill specifies the Department of Corporations shall forward to the Franchise Tax Board (FTB) at least annually, or more frequently upon request, a list of all health care services plans licensed under Section 1353 of the Health and Safety Code which are required to provide the basic health care services defined in Section 1345 of the Health and Safety Code. The Department of Insurance shall forward to the FTB at least annually, or more frequently upon request, a list of all insurers authorized to transact disability insurance in this state and nonprofit hospital service plan corporations holding the certificate of authority required by Section 11504 of the Insurance Code.

This bill specifies that to be eligible for the credit, each disability insurance policy or health care service plan shall be certified as providing the basic health care services described, and if applicable, either or both of the supplemental benefits, by legal opinion of the plan's counsel, a copy of which shall be provided to each eligible employer to be retained for submission to the FTB upon request.

This bill would establish in the State Treasury the Tobacco Settlement Fund to receive money paid annually to the state pursuant to a federal universal tobacco settlement. The money in the fund shall, upon appropriation by the Legislature, be used for purposes of the tax credit created by this act.

Constitutional Consideration

This bill would restrict the health care coverage credit to California residents, which may raise constitutional discrimination concerns by virtue of the credit being available only to employees who are residents, rather than to all employees who are employed within California (and are thus themselves subject to California tax on their earnings). This issue may be eliminated by instead simply requiring that employees work within California for the employer to claim the credit.

Policy Considerations

This bill would allow a credit to small businesses which are corporations, but not to those which are formed as sole proprietorships, partnerships, or limited liability companies, creating inequitable treatment among businesses.

This bill does not specify a repeal date or limit the number of years for the carryover. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness. However, even if a repeal date were added, the department would be required to retain the carryover on the tax forms indefinitely because unlimited credit carryover is allowed. Recent credits have been enacted with a carryover limit since experience shows credits are typically used within eight years of being earned.

Implementation Consideration

This bill would require money in the Tobacco Settlement Fund to be appropriated by the Legislature to be used for this credit. It is unclear if this means that the credit could only be allowed to the extent of the Settlement Fund moneys which have been appropriated. Given that many businesses use different fiscal years, resulting in the year-round filing of corporate tax returns, and that taxpayers may receive the benefit of their credit by reducing their estimate payments, such a direct link between the appropriated money and the amount of credit may be impossible to administer.

Once this concern is resolved, implementation of this bill is not expected to significantly impact the department.

Technical Considerations

This bill provides rules regarding the division of credits among taxpayers who share in the costs and among partners in a partnership. These rules are essentially identical to the general rules already contained in B&CTL Section 23036 and are essentially unnecessary. However, the language of the credit limits eligibility to taxpayers that pay 75% of the cost. If several taxpayers share costs but none pay 75%, the possibility exists that there would be no 'eligible' taxpayers. The language regarding division of the credits needs modification to ensure that the author's intent is achieved.

Subdivision (a) specifies that the credit is equal to the sum of the amounts determined under subdivisions (b) and (c). However, subdivision (i) allows an additional $5 tax credit per month per covered employee for each of the two supplemental benefits. Subdivision (a) should be amended to include the credit calculated under subdivision (i), or the bill should be restructured to bring the supplemental benefits credit into an earlier subdivision.

It is unclear if subdivision (i) would allow the additional $5 credit if dependents used the supplemental benefits or only if employees utilized each of the two supplemental benefits.

Subdivision (b) needs to be amended where the term “covered individual” appears, as it should be “eligible individual” to correspond to the definition in subdivision (h).

Subdivision (g) specifies that the health care premiums paid by the employer are not included in the employees’ gross income for California purposes. This subdivision is misplaced in that individual income tax provisions should be addressed in the Personal Income Tax Law (PITL). However, this subdivision can be deleted as it is unnecessary to reiterate state law (Revenue and Taxation Code Section 17131), which is in conformity to federal law (Internal Revenue Code Section 106).

Subdivision (k) references “disability insurance policy” but disability coverage is not included under the health coverage discussed earlier in the bill. The bill should be amended to delete or clarify this reference as it could be confusing to taxpayers.

FISCAL IMPACT

Departmental Costs

Once the implementation issue is resolved, this bill is not expected to impact the department’s costs.

Tax Revenue Estimate

The revenue impact of this measure, under the assumptions discussed below, is estimated to be as follows in applied credits:

Revenue Impact of AB 1262
Beginning 1/1/2001
(In Millions)

	2000-1	2001-2	2002-3
Revenue Impact	($75)	($345)	($565)

As with other analyses for health insurance tax credits, it is assumed that in cases where the business has unitary affiliates, firm size would be based on total employees for the combined group. This analysis does not account for changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The revenue impact of this proposal would depend upon the number of employers who would incur qualified health-related expenses for qualified employees, the average costs of qualifying expenses, and the tax liabilities of employers.

Using EDD data, it was estimated that about 50% of employees working in firms with no more than 50 employees earned hourly wages of $20 or less. Using the same data source and the information obtained from the U.S. Small Business Administration, it was estimated that about 40% of these employees had health insurance coverage for whom employers incurred at least 75% of the cost. The cost of health insurance ($304 per family per month) was obtained from a study conducted by the University of California. It was assumed that employers on average would incur 85% of the costs. An employer incentive effect due to the credit was allowed starting at around 5% and reaching 15% after three years. It was further assumed that 80% of the credits could be used in the current year with the remaining carried over to succeeding years.

BOARD POSITION

Pending.